

A REPORT
TO THE
ARIZONA LEGISLATURE

Accounting Services Division

Procedural Review

Ash Creek Elementary School District No. 53

As of April 24, 2007



Debra K. Davenport
Auditor General

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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

July 30, 2007

Governing Board
Ash Creek Elementary School District No. 53
6460 East Highway 181
Pearce, AZ 85625

Members of the Board:

We performed a procedural review of the internal controls of Ash Creek Elementary School District No. 53 as of April 24, 2007. The purpose of a procedural review is to determine whether a district is in substantial compliance with the *Uniform System of Financial Records for Arizona School Districts* (USFR). Our review consisted primarily of inquiries, observations, and selective testing of accounting records and control procedures. The review was more limited in scope than would be necessary to express an opinion on the District's internal controls. Accordingly, we do not express an opinion on its internal controls or ensure that all deficiencies were disclosed.

As a result of our review, we noted significant deficiencies in internal controls that indicate the District has not complied with the USFR. District management should implement the recommendations we have described in this report within 90 days after the date of this letter. We have communicated specific details for all deficiencies to management for correction.

During the 90-day period, the District may request a meeting to discuss these recommendations with my Office and the Arizona Department of Education by calling Magdalene Haggerty, Accounting Services Director, or Jerry Strom, Accounting Services Manager.

A member of my staff will call the Business Manager in several weeks to discuss the District's action to implement these recommendations. After the 90-day period, my staff will schedule an on-site review of the District's internal controls to determine whether the District is in substantial compliance with the USFR. Our review will cover the deficiencies we have communicated to management as well as any other internal control deficiencies we are aware of at the time of our review.

Thank you for the assistance and cooperation that your administrators and staff provided during our procedural review. My staff and I will be pleased to discuss or clarify items in this report.

Sincerely,

Debra K. Davenport
Auditor General

TABLE OF CONTENTS



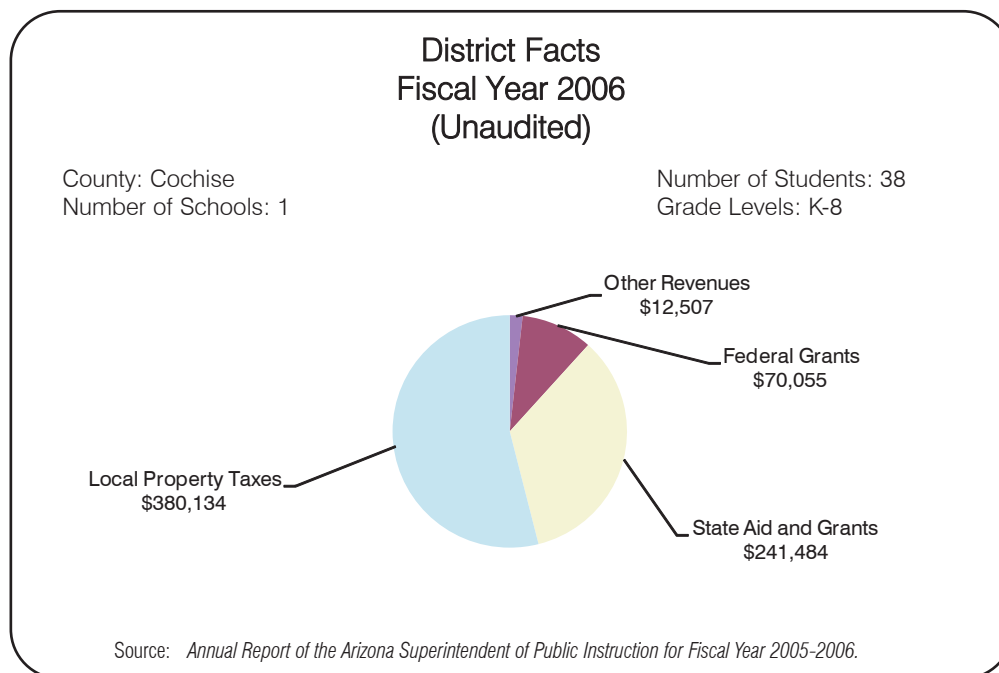
Introduction	1
Recommendation 1: The District should maintain capital assets and stewardship lists	2
Recommendation 2: The District's controls over purchasing and expenditures should be improved	3
Recommendation 3: The District should improve its controls over food service cash receipts	5
Recommendation 4: The District should improve its controls over payroll processing	6
Recommendation 5: The District should maintain and report accurate financial information	7

INTRODUCTION

Ash Creek Elementary School District No. 53 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for over \$700,000 it received in fiscal year 2006 to provide this education.

The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education (ADE). The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our procedural review, we determined that the District had not complied with the USFR. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship and to comply with the USFR. Our recommendations are described on the following pages.



The District should maintain capital assets and stewardship lists

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. Effective stewardship requires the District to have accurate lists of these assets to ensure they are properly accounted for.

The District did not protect its investment in capital assets since it did not prepare capital assets or stewardship lists.

However, the District did not have a capital assets list for items costing \$5,000 or more, or a stewardship list for items costing between \$1,000 and \$5,000. Additionally, the District did not tag or otherwise identify all assets as district property and has not taken a physical inventory of equipment for at least 15 years. Further, the District did not reconcile capital acquisitions to capital expenditures for the year ended June 30, 2006.

Recommendations

The following procedures can help the District improve control over its capital assets and help ensure accurate and complete capital assets and stewardship lists are maintained:

- Prepare and maintain a capital assets list of all assets costing \$5,000 or more with useful lives of 1 year or more, and a stewardship list of all equipment items costing between \$1,000 and \$5,000. Include all required information for each item on the lists.
- Classify capital assets in the correct category (i.e., land and improvements, buildings and improvements, and equipment).
- Affix a tag with an identifying number to each equipment item costing \$1,000 or more, or specifically identify the asset on the stewardship or capital assets list by some other means, such as a serial number. Tag numbers should be prenumbered, numerically controlled, and issued sequentially.
- Retain cost documentation for all items recorded on the capital assets list and verify that the cost of each item on the list agrees to such documentation. If the District cannot locate documentation to support the actual cost of an asset, it may use estimated historical cost obtained from appraisals, bond issue documents, governing board minutes, or vendor catalogs.
- Perform a physical inventory of all equipment items at least every 3 years following USFR guidelines. Retain written instructions, inventory count sheets, and other documents relating to the physical inventory, including reconciliations.

USFR pages VI-E-2 and 3 and USFR Memorandum No. 196 describe information that should appear on the capital assets and stewardship lists.

Instructions for performing a physical inventory of capital assets are listed on USFR pages VI-E-8 and 9.

- Assign an employee who has no custodial responsibilities to reconcile the results of the physical inventory to the capital assets and stewardship lists, and add items to or remove items from the lists as necessary.
- Reconcile items added to the capital assets list during the fiscal year to capital expenditures, and make all necessary corrections.

The form on USFR page VI-E-13 may be used to document the reconciliation of capital asset additions to capital expenditures.

The District's controls over purchasing and expenditures should be improved

School District Procurement Rules for competitive sealed bidding and USFR guidelines for purchases below the competitive sealed bid threshold promote open and fair competition among vendors. This helps ensure that districts receive the best possible value for the public monies they spend. However, the District did not follow USFR guidelines, as it did not analyze the known requirements for an item or a collection of items that, in aggregate, would result in purchases above \$5,000. As a result, the District did not obtain oral price quotations for purchases that required them. In addition, the District did not perform due-diligence procedures for purchases made through a purchasing cooperative.

The District may not have received the best possible value for the public monies it spent.

Also, it is essential that the District follow proper expenditure processing procedures. However, the District did not follow such procedures since it did not always properly prepare and retain purchase orders, prepare receiving reports, perform clerical accuracy checks on vendor invoices, or cancel supporting documentation. Additionally, the District did not retain documentation to support credit card purchases, did not investigate all charges before paying credit card bills, and often incurred finance charges due to late payments. Further, the District did not prepare and retain supporting documentation for travel expenditures or ensure meal reimbursements were within the Arizona Department of Administration's (DOA) prescribed limits.

Recommendations

To strengthen controls over purchasing and expenditures, the District should establish and follow the policies and procedures listed below:

Purchasing

- Determine whether to request oral or written price quotations, or issue invitations for bids or requests for proposals by analyzing the known requirements for an item or a collection of items that, in the aggregate, may result in purchases above the applicable thresholds.
- Obtain oral price quotations from at least three vendors for purchases estimated to cost between \$5,000 and \$15,000. If the District cannot obtain three price quotations, it should document the vendors contacted who did not offer price quotations and their reasons for not doing so.
- Perform and document due-diligence procedures on at least a sample of the contracts that the District wishes to use from a purchasing cooperative to ensure that the contracts were bid in accordance with the School District Procurement Rules.

Expenditures

- Prepare and retain prenumbered and numerically controlled purchase orders for all purchases requiring them.
- Prepare receiving reports for all goods and services received, except exempted items, that include the date of receipt, quantity received, and signature of the recipient.
- Review vendor invoices for mathematical accuracy and indicate evidence of the review on the invoice.
- Cancel invoices and supporting documentation by stamping them "paid" in order to prevent duplicate payment.
- Prepare and retain travel claims and supporting documentation for travel expenditures and ensure reimbursements for meals are within DOA's prescribed limits.

USFR pages VI-G-2 through 5 describe expenditure processing procedures.

USFR Memorandum No. 226 includes the maximum travel reimbursement rates established by the DOA.

- Obtain and retain adequate supporting documentation for credit card purchases, including signed credit card receipts and itemized vendor receipts. The documentation should clearly indicate the employee making the purchase and the purpose of the charge.
- Pay credit card balances in full when due to avoid finance or late charges.

The District should improve its controls over food service cash receipts

Significant amounts of cash may be collected through food service operations, and because cash is more susceptible to manipulation than any other asset, it is essential that districts establish policies and procedures so that cash receipts are adequately safeguarded and accurately reported. However, the District did not have adequate internal controls in place to help ensure that food service cash receipts are safeguarded and accurately reported. Specifically, the District did not issue cash receipt forms, deposit cash receipts in the Food Service Fund clearing bank account in a timely manner, and did not retain deposit slips for all monies deposited. Also, the District allowed adults to charge meals, did not always accurately reconcile meals served to meals sold, or accurately calculate individuals' account balances based on the number of meals used and monies received.

Food Service cash receipts were susceptible to loss or theft.

Recommendations

To help strengthen internal controls over food service monies, the District should:

- Issue prenumbered and numerically controlled cash receipt forms promptly when monies are received.
- Deposit receipts intact daily, if significant, or at least weekly in the Food Service Fund clearing bank account.
- Retain validated deposit slips for all monies deposited.
- Require adults to pay for meals when received or in advance.

- Reconcile the amount of cash receipts and meals served to the individual adult and student accounts.
- Require a second employee to review the weekly summary of meals served and account payments received, and the reconciliation to individuals' account balances. Any overages, shortages, or clerical errors should be investigated and resolved promptly.

The District should improve its controls over payroll processing

Salaries, wages, and related payroll costs are a major portion of the District's total expenditures. Therefore, it is critical for the District to have strong payroll controls to ensure that employees are paid accurately, required deductions are withheld, and that adequate records are maintained to support payroll expenditures. However, the District did not have adequate controls over payroll processing. Specifically, the

Payroll timecards were not prepared correctly and did not always support amounts paid to hourly employees.

District did not adequately separate the duties of payroll preparation and authorization. Also, the District did not ensure employee personnel files included all required documentation and that timecards for all hourly employees were prepared, signed by the employee, approved by a supervisor, and adequately detailed to support amounts paid to employees. Further, in December 2006, the District issued "bonus" checks to each employee ranging from \$100 to \$600 for a total of \$3,200. These payments were in violation of the constitutional provision prohibiting gifts of public monies and were not subjected to payroll withholdings.

Additionally, the District's policies governing employee leave did not include accrual rates, maximum amounts allowed to be accrued, and disposition of accrued vacation or annual leave upon termination of employment. Also, the District did not retain documentation to support the approval of leave in advance and paid one employee for more vacation days than had been accrued. Finally, the District's termination procedures did not require preparation of a clearance form by the employee's supervisor to ensure that keys, equipment, and credit cards were returned.

Recommendations

To help strengthen controls over payroll processing, the District should:

- Separate payroll preparation and authorization duties so that one employee does not perform all duties. If one employee must perform multiple functions, district management should implement additional supervisory review at appropriate points in the process.

- Maintain all required documentation in employee personnel files.
- Have hourly employees prepare timecards for each pay period. Timecards should be properly completed and indicate the dates and hours worked, and be signed by the employee and supervisor to indicate approval. Additionally, these timecards should be used to support the amounts paid to hourly employees in accordance with the Fair Labor Standards Act and to support accrued leave used.
- Ensure that expenditures including payments to employees do not violate the gift of public monies clause in the Arizona Constitution, Article 9, §7. Pay employees only for hours worked and accrued leave taken and refrain from paying employees bonuses or compensation that is not included in the terms of the employee's contract or work authorization unless additional duties not related to the employee's normal responsibilities are performed for such compensation.
- Establish policies and procedures, and maintain a system to account for the accrual and use of vacation, personal, sick, and compensatory leave for all employees. Policies and procedures governing leave should include prescribed accrual rates for specified years of service, maximum amounts allowed to be accrued, and disposition of accrued leave upon termination of employment.
- Prepare leave approvals for other than emergency or sick leave in advance of leave being taken. Additionally, leave balances should be verified prior to approval of the leave and again before payment of leave is processed.
- Require that a clearance form be prepared by a supervisor for terminating employees to ensure that keys, equipment, and credit cards are returned.

The District's personnel files should include the documents listed on USFR pages VI-H-2 through 4.

The District should maintain and report accurate financial information

The District's Governing Board depends on accurate information to fulfill its oversight responsibility. The District should also report accurate information to the public and agencies from which it receives funding. To achieve this objective, management should ensure that its accounting records are accurate and complete. However, the District did not fully accomplish this objective. Specifically, the District did not always accurately classify expenditures in its accounting records. Additionally, the District did not retain a copy of its fiscal year (FY) 2006 Advice of Encumbrance and exceeded its FY 2006 budget

The District did not prepare a sufficient Classroom Site Fund Performance Pay Plan or documentation adequate to support payments made to employees.

in the Unrestricted Capital Outlay Fund. Further, the District's Classroom Site Fund Performance Pay Plan was not sufficiently detailed to allow employees to determine what, if any, performance payment they would be entitled to, and the District did not document the basis for the amounts paid. Finally, the District did not document the actual number of miles traveled to transport eligible students to and from school and related activities. As a result, it appears that the District may have overestimated such miles by as much as 9,500 miles on the District's Transportation Route Report filed with ADE.

Recommendations

To help ensure accuracy of the District's financial information, it should:

- Classify all transactions in accordance with the USFR Chart of Accounts.
- Prepare and retain a copy of its Advice of Encumbrance to monitor spending within budget limits during the 60 days following each fiscal year-end.
- Verify that sufficient cash or budget capacity exists in funds before approving purchases.
- Prepare a detailed Classroom Site Fund Performance Pay Plan and document the measurement of plan objectives to support the determination of amounts that employees should receive under the plan. The plan's goals should be specific and measurable, and documentation of employees' achievement or progress toward goals should support payments made, or withheld, under the plan.
- Require bus drivers to prepare daily logs of miles driven to transport eligible students to and from school. Drivers should also log activity mileage or other miles driven, such as miles for repair trips.
- Prepare the District's Transportation Route Report based on actual logged miles transporting students from the bus drivers' daily logs.